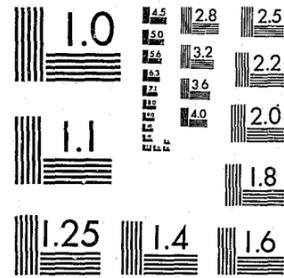


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MEASURING WHITE COLLAR CRIME:

THE USE OF THE "RANDOM INVESTIGATION" METHOD FOR ESTIMATING TAX OFFENSES

by

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ABSTRACT

Traditional measures of the frequency and character of index offenses and other street crimes are based largely upon victim reports-- either from offenses reported to the police, or from victim surveys. Despite many limitations in reporting, recording, and compilation, victim reports do provide at least a starting point for estimating crime rates. Large areas of the criminal law, however, are not covered by victim reports -- whether because there aren't victims in the usual sense (the so-called victimless crimes), or because of the nature of the offense victims are unaware they have been victimized. In this latter category fall large segments of white collar crime. This paper examines the use of an alternative approach for measuring offense rates, the "random investigation" method, as applied to federal income tax violations. Estimates are derived for the level of tax noncompliance by individuals, and the rates for serious civil and criminal offenses.

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Traditional measures of the frequency and character of index offenses and other street crimes are based largely upon victim reports-- either from offenses reported to the police, or from victim surveys. Despite many limitations in reporting, recording, and compilation, victim reports do provide at least a starting point for estimating crime rates. Large areas of the criminal law, however, are not covered by victim reports -- whether because there aren't victims in the usual sense (the so-called victimless crimes), or because of the nature of the offense victims are unaware they have been victimized.¹ In this latter category fall large segments of white collar crime. For these, alternative data sources must be developed to estimate the extent of law violations.

Data on enforcement actions, while valuable in studying government response to law infractions, generally do not provide an alternative basis for estimating the extent of such crimes since they are as much a product of agency resources and priorities, as of offense prevalence. Limited resources, for example, prevent many offenses from being adequately investigated; many remain unknown to enforcement authorities. Changes in enforcement trends are as likely to reflect shifts in agency or public priorities, as any "real" change in crime rates.

The drawbacks of using enforcement records as a source for estimating offense rates would be reduced if some means were found to draw a "representative sample" of potential violations for intensive

¹Some victims are hesitant to report because they would be implicated in the offense.

investigation. Results from these sample investigations could then be used to estimate actual offense prevalence. This paper examines results based upon the use of the "random investigation" approach in measuring federal income tax violations.

ESTIMATING TAX NONCOMPLIANCE: THE RANDOM INVESTIGATION

Detailed tax investigations of a random sample of persons, locations, or events provide one basis for estimating the extent of tax violations. First employed by IRS in its 1948 Audit Control Program,² the use of this technique was expanded with the establishment of IRS's Taxpayer Compliance Measurement Program (TCMP) in 1962. Since then some 20 separate TCMP studies have been conducted covering different tax areas ("Phases") and tax years ("Cycles"). These have been used to estimate the nature and extent of failure to timely pay required taxes (Phase I), file required returns (Phase II), or correctly report tax liability on filed returns (Phases III-VII).

TCMP Sampling and Data Collection Procedures.

Sampling techniques have varied by TCMP phases. Estimates for nonfilers have been based largely upon canvassing sampled geographic areas; the extent and reasons for delinquent payments were based upon samples of notices and bills issued to taxpayers of unpaid tax balances.

²Early uses of the random investigation method to assess tax compliance were the Audit Control Program after World War II, and the Audit Research Program in the early sixties. These included studies of 1948 individual income tax returns, 1949 individual and small corporation income tax returns (including payroll and certain excise taxes), and 1960 low income individual income tax (less \$10,000 nonfarm business) returns. (See Farioletti, 1952, 1958; Commissioner's Annual Report 1949, 1950; IRS, The Audit Control Program; IRS Manual Supplement 48G-31 (May 5, 1961) and 48G-35 (February 23, 1962); IRS Document 6457(9-77).)

Collection Division personnel have carried out the surveys of delinquent accounts and delinquent returns (nonfilers), though the last survey in these areas was conducted in 1971.

Errors in the reporting of tax liabilities have been estimated using stratified cluster samples of filed returns. Experienced revenue agents and tax auditors from IRS Examination Division conduct in-depth audits of each of the sampled returns. Detailed checksheets are made out by the IRS examining officer of the amounts reported line by line on the return and "corrected" amounts after audit. Supplemental information concerning the taxpayer's financial affairs, who prepared the tax return, and what procedures were used in carrying out the TCMP examination are also included. In the recent (TCMP-Phase III, Cycle 6) survey of 1976 individual tax returns filed in 1977, for example, 190 separate numbered items of information are covered on the checksheet (reproduced at Table 1), with additional information required where there is partnership income.

After a TCMP audit is completed, internal procedures call for administrative review of the checksheets for quality control. In addition, for some surveys a subsample of checksheets and related audit workpapers have been examined by IRS's Internal Audit Division to determine the extent required TCMP policies and procedures have been properly carried out. After being reviewed, transcribed and appropriately weighted, these TCMP sample results provide extremely detailed data on the frequency, amount and character of tax noncompliance and its distribution across taxpayers.

TABLE 1
DATA COLLECTION INSTRUMENT FOR TCMP SURVEY
OF 1976 INDIVIDUAL INCOME TAX RETURNS.

TABLE 1. (con't - 1)

TCMP Individual Audit Evaluation Document - 1976				2. Occupation Code		Data Center Use	
1. Taxpayer				3. Method Used to Examine Return		Office Audit	
						Field Audit	Office
				Assigned	(1)	(3)	(5)
				Closed	(2)	(4)	(6)
PART I - TCMP RELATED DATA							
4. TCMP Return Prepared By	(1) <input type="checkbox"/> No Assistance	Unpaid Assistance	(2) <input type="checkbox"/> IRS Assistance Only	(3) <input type="checkbox"/> IRS Preparation	(4) <input type="checkbox"/> IRS Reviewed	(5) <input type="checkbox"/> VITA Assisted	(6) <input type="checkbox"/> Other
	Paid Assistance				Check One (Where Appropriate)		
	(7) <input type="checkbox"/> CPA	(8) <input type="checkbox"/> Public Acct.	(9) <input type="checkbox"/> Attorney	(10) <input type="checkbox"/> CPA & Atty.	(11) <input type="checkbox"/> Local Tax Service	(12) <input type="checkbox"/> Nat'l. Tax Service	(13) <input type="checkbox"/> Other
					(1) Yes	(2) No	(3) N/A
5. Did preparer sign or stamp return?				5			
6. Was signature or stamp of preparer legible?				6			
7. Did preparer enter his/her EIN or SSN?				7			
8. Did taxpayer use IRS plain language publications listed in Publication 900?				8			
9. Did taxpayer receive classroom instruction prior to Return Preparation?				9			
10. If item 9 is yes, enter year of most recent training: 19 _____				10			
11. Indicate how foreign accounts question was answered. (N/A means "Not Answered")				11			
12. Did taxpayer(s) actually have a foreign account?				12			
13. Did activity in foreign accounts lead to a tax adjustment?				13			
14. If yes, enter portion of total tax change due to adjustment \$ _____				14			
15. Was TCMP return the subject of a fraud investigation and/or referral?				15			
16. Did TCMP examination result in any other fraud investigation and/or referral?				16			
17. Was income verified or corrected by use of indirect method (Net Worth etc.)?				17			
18. If a deduction was claimed on Schedule C or F for Employee Benefit Plan, was a Form 5500, 5500-C or 5500-K filed?				18			
19a. Did taxpayer receive a lump-sum distribution from an employee benefit plan(s)?				19a			
19b. If yes, was a Form 1099R received?				19b			
19c. If taxpayer received a lump-sum taxable distribution, was all or part of it a rollover into a qualified plan or an Individual Retirement Savings Program?				19c			
PART II - CONTROL DATA							
20. Examining Officer's Name		21. Grade		22. Time on TCMP Return		10	
23. Group Manager's Initials		24. Date		25. Form 3628 Reviewed by Group Manager		10	
				1. <input type="checkbox"/> Yes 2. <input type="checkbox"/> No			
26. TCMP Reviewer's Initials		27. Date		28. Time		10	
29. Disposal Code		30. Closing District Code		31. Conferee's Initials		10	
				32. Date		33. Time	
						34. Principal Issue Number	
Remarks (Use Reverse of Page 3 for Additional Space)							

PART III - TAX BASE DATA									
		(1) Reported	(2) Corrected			(1) Reported	(2) Corrected		
SECTION A - INCOME	Wages, Tips, etc.	35.			SECTION D - EXEMPTIONS	Taxpayer Regular	74.		
	Dividends	36.				65 or Over, Blind	75.		
	Interest	37.				Spouse Regular	76.		
	Schedule C (Item 144)	38.				65 or Over, Blind	77.		
	Schedule D (Item 179)	39.				Children Same Address	78.		
	Form 4797	40.				Different Address	79.		
	Pensions and Annuities	41.				Parents Same Address	80.		
	Rents (Item 150)	42.				Different Address	81.		
	Royalties	43.				Other Dependents	82.		
	Form 1065	44.				Total (Items 74-82)	83.		
	Form 1041	45.				TAXABLE INCOME (Item 59 minus 80, 73, 83)	84.		
	Form 1120S	46.				FILING STATUS (Code)	85.		
	Schedule F (Item 172)	47.				<input type="checkbox"/> Not Applicable	86.		
	State Income Tax Refund	48.				Tax Table	87.		
Alimony	49.			Tax Rate Schedule	88.				
Other	50.			Schedule D	89.				
Total (Items 35-50)	51.			Schedule G	90.				
SECTION B - ADJUSTMENTS	<input type="checkbox"/> Not Applicable	52.			Form 4726 (Maximum)	91.			
	Moving Expense	53.			Other	92.			
	Employee Business Expense	54.			Elderly	93.			
	Payments to IRA	55.			Investment	94.			
	Payments to Keogh	56.			Foreign Tax	95.			
	Sick Pay	57.			Child Care	96.			
	Other	58.			General Tax	97.			
	Other	58.			Other	98.			
	ADJUSTED GROSS INCOME (Item 59 minus 52-58)	59.			NET INCOME TAX (Item 87-92 minus 93-98)	99.			
	Standard Deduction	60.			Minimum Tax	100.			
SECTION C - DEDUCTIONS	ITEMIZED	Deductible 1/2 Medical Insurance Premium	61.		Self Employment Tax	101.			
		Other Deductible Medical	62.		Other Taxes	102.			
		State & Local Income Taxes	63.		Total (Items 99-102)	103.			
		Real Estate Taxes	64.		Income Tax Withheld	104.			
		Other Taxes	65.		Earned Income Credit	105.			
		Home Mortgage Interest	66.		Estimated Tax	106.			
		Other Interest	67.		Excess FICA	107.			
		Contributions			Other	108.			
		Cash	68.		Total Credits and Pre-payments (Items 104-108)	109.			
		Other	69.		BALANCE DUE (Item 103 minus 109)	110.			
		Casualty/Theft Losses	70.		Tax Paid with Return	111.			
		Alimony	71.		Balance Due After Payment in Item 111	112.			
		Other	72.		OVERPAYMENT (Item 109 minus 103)	113.			
		Total (Items 61-72)	73.		Penalties	114.			
114a. (1) <input type="checkbox"/> Fraud (2) <input type="checkbox"/> Negligence (3) <input type="checkbox"/> Other									

distribution of taxpayers by income levels and return categories, the right-hand panel of Table 2 presents what, other things equal, TCMP estimates of noncompliance would have been had the 1973 income or return distribution existed in prior years.⁴

Unadjusted, all three TCMP indices show some increase in measured tax noncompliance over the ten year period. The proportion of returns underreporting tax increased from one in three in 1963 to four in ten in 1973. The proportion of net tax underreported (NCL)⁵ increased from 6.0 to 6.7 percent, and the average tax change even after taking inflation into account rose 50 percent.

However, all of the increase in the size of the tax error is accounted for by the movement of taxpayers into higher income brackets. Once this adjustment and inflation is taken into account, the average amount of tax underreported remains roughly unchanged--\$152 in 1963, \$146 in 1973. But, both the percent of returns with underreporting errors, and the proportion of tax underreported show even larger increases after adjustment. Because general reduction in tax rates between 1963 and 1973 lowered average tax liabilities (in constant dollars), as a proportion of total tax liabilities, this unchanging amount of tax error translated into an increasing underreporting rate

⁴A change in category definition further implicates the data. For the 1963 and 1965 surveys, the "standard deduction" return category includes only those filing on the short 1040A form. In later years, it includes all, those with 1040A type characteristics, even if a regular 1040 form was used. (In 1969, there was no Form 1040A.)

⁵Because some taxpayers overreport rather than underreport, net underreporting represents the difference between aggregate under- and over-reporting. The proportion of net tax underreporting or noncompliance level (NCL) is thus defined: $NCL = (\text{Tax should have been reported} - \text{Tax reported}) / \text{Tax should have been reported}$. Or, $NCL = (\text{Tax underreported} - \text{Tax overreported}) / (\text{Tax Reported} + \text{Tax underreported} - \text{Tax overreported})$

TABLE 2

TCMP PHASE III: INDIVIDUAL INCOME TAX RETURNS

Tax Year	Underreporting of Tax on Filed Returns							
	TCMP				TCMP (Adjusted) ^a			
	Percent of Returns Underreported (1)	Percent of Net Tax Underreported (2)	Average Per Return		Percent of Returns (5)	Percent of Net Tax (6)	Average Per Return	
			\$ (3)	Constant 1978 \$ ^b (4)			\$ (7)	Constant 1978 \$ ^b (8)
1963	33.1	6.0	\$50	\$107	31.9	4.8	\$71	\$152
1965	33.5	5.2	42	87	32.3	4.1	49	101
1969	40.9	6.4	80	143	39.2	5.5	87	155
1973	39.7	6.7	99	146	39.7	6.7	99	146
Ratio 1973/1963	1.2	1.1	2.0	1.4	1.2	1.4	1.4	1.0

SOURCE:

^a Distribution of returns and tax dollars adjusted so that distribution returns (col.5) or taxes (cols.6-8) across ten IRS audit categories (classified by level and source(s) of income) for earlier years equal to that occurring in 1973. This adjustment was made to control for changing distribution of taxpayer income levels between 1963-1973.

^b Dollars expressed in 1978 constant dollar terms to adjust for changes resulting from inflation.

(NCL)—up 40 percent over the ten year period.⁶ Also despite rising income levels, more people took the standard deduction in 1973 because of a significant statutory increase in the deductible amount. Such simple returns have lower rates of error. As a result the unadjusted totals showed smaller gains in the proportion of returns with error, than after adjustment.

When we to remove "standard deduction" tax returns (with adjusted gross income less than \$10,000), returns with underreporting increase to over half for wage-earners, and to two out of three returns for individuals with business or professional income, and involve even higher amounts (and rates) of tax underreporting.

TCMP DATA ON SERIOUS INCOME TAX OFFENSES

At first glance, these rates of tax "violations" may appear unbelievably high. But they cover a diverse array of behaviors, most of which have little to do with tax evasion per se. Given the complexity of the law, inadvertent errors are common. Further many tax requirements are subject to interpretation, where opinions vary even among experts. It is therefore important to clearly distinguish between the bulk of these errors which are relatively minor and civil in nature and serious tax offenses: criminal offenses and civil violations where at least negligence or fraud is involved.

⁶This reduction in tax liability for taxpayers as a whole does not show up in the unadjusted TCMP estimates of total tax liability because rising income levels moved people into higher tax brackets. The TCMP estimates of the "true" tax liability (in constant dollars) averaged \$1663 in 1963, and \$2024 in 1973.

Estimates of Criminal Income Tax Offenses on Filed Returns

Again based upon TCMP data from Phase III, rates of criminal income tax violations were estimated by the author for returns filed by individuals. Results are shown for criminal income tax violations in Table 3.

Rates of referral for potential criminal tax evasion averaged 18 per 10,000 returns across the three surveys.⁷ Though based on only 668 cases out of a combined sample of over 140,000, rates for each of the three surveys (despite even smaller n's) were surprisingly close: 22 (1965); 16 (1969); 17 (1973) per 10,000.⁸ After adjusting for certain cases excluded from these tabulations, an estimated rate of 20 per 10,000 was obtained.⁹ (Referral rates under the regular audit program, where returns are selected for their audit potential, average around 42 per 10,000 returns (unpublished internal IRS tabulations).)

⁷Delays have been encountered in receiving photocopies of relevant 1963 TCMP tabulations from the Service; hence they could not be included in the above analysis.

⁸The sampling ratio differed by strata, making the design several times more efficient than a simple random sample of the same size. Because criminal violations are relatively rare, however, even a sample of 50,000 (the typical TCMP sample size) even when efficiently designed included only a very small number of cases referred for potential criminal violations. Thus, expected sampling variability of any estimate remains sizable, and the close correspondence of our estimates across TCMP surveys is a happy, but unexpected, event.

⁹Cases selected for the TCMP sample which were already under criminal investigation were excluded from the tabulations. While data for earlier TCMP surveys were not retained, figures for the latest cycle (III-69 record 22 exclusions for this reason (out of a total sample of approximately 50,000). This figure of 22 per survey was used to adjust (22X3 = 734 - 668) the number of returns referred. In the absence of information on the distribution of these exclusions across sampling strata, a straight 10% upward adjustment (66/668) was made in the estimated rate of criminal referrals from 18 to 20 per 10,000.

TABLE 3

Estimated Criminal Income Tax Violation Rates
Returns Filed by Individuals

Taxpayer Compliance Measurement Program Survey	Tax Year	Sample Size (returns)	Referral for Potential Criminal Tax Violation	
			Number of Returns	Rate per 10,000 Returns ¹
III-2	1965	41,440	125	22
III-3	1969	47,534	268	16
III-5	1973	51,402	275	17
Total Combined Sample		140,376	668	18
Adjusted ² for exclusions			734	20
Estimated Rate of Criminal Offenses				1-2 ³

Source: Taxpayer Compliance Measurement Program, Returns Filed Phase III, Cycles 2, 3, 5, weighted and unweighted diagnostic tables: 5/990, 9/990, 3/990; A, C tables (RAT).

¹The sampling ratio varied by strata; the rate shown is based upon the weighted frequencies, taking into consideration the varying sampling ratios.

²Cases selected for the TCMP sample which were already under criminal investigation were excluded from the tabulations. While data for earlier TCMP surveys were not retained, figures for the latest cycle (III-6) record 22 exclusions for this reason (out of a total sample of approximately 50,000). This figure of 22 per survey was used to adjust (22X3 = 734-668) the number of returns referred. In absence of information on the distribution of these exclusions across sampling strata, a straight 10% upward adjustment (66/668) was made in the estimated rate of criminal referrals from 18 to 20 per 10,000.

³No compilations were available on the outcome of criminal fraud referrals. The estimate of 1-2 taxpayer convictions per 10,000 returns based upon experience from the regular/crim program. There are approximately 1.5 taxpayers per return on average; The estimated rate of potential criminal convictions per 10,000 taxpayers is 0.8-1.1.

A referral for potential criminal tax violation is not the same as a finding of criminal tax evasion. Though data were collected on the results of these referrals, they were apparently never compiled. The only guide in transforming this figure on referrals, into potential criminal tax convictions, comes from the regular tax investigation program. Referrals go through several steps before an indictment is filed. First, the IRS Criminal Investigation Division screens referrals for those warranting further investigation. Only 30 to 40 percent of referrals from the regular audit program are accepted for criminal investigation. Of those which are fully investigated, only roughly 40 percent are recommended for criminal prosecution; and of those recommended, less than half are indicted or convicted.¹⁰

Thus, based upon the regular referral program, only about 5-10¹¹ out of 100 audit referrals end up as criminal convictions. Such a winnowing process implies that the TCMP referrals of 20 per 10,000 might translate into 1-2 criminal convictions per every 10,000 returns.¹²

For the more than 87 million individual income tax returns filed last year, these data suggest potential criminal violators numbering somewhere around 10,000. This figure may strike one as awfully low. Of course, these figures do not include criminal nonfilers, nor do they

¹⁰According to IRS directives, lack of investigative resources is not a grounds for rejecting a referral for criminal investigation. Even after acceptance of the referral, only a small number (5-10%) are recorded as closed for lack of resources.

¹¹Figures vary by source. Data though limited from the Examination (Audit) Division on their referrals differ from Criminal Investigation Division statistics on receipts of audit referrals.

¹²Criminal convictions are based upon counts of taxpayers; the rate, however, is relative to return filings which average -- exclusive of dependents -- roughly 1.5 taxpayers per return.

include corporate tax offenses. Among current criminal tax prosecutions, roughly 25 percent involve nonfilers (though this proportion as likely reflects policy priorities as incidence). Perhaps more important, these figures reflect incidents which not only would be detected under present IRS investigation procedures, but prosecuted under current prosecution standards -- something that may tell us more about IRS choice of civil over criminal enforcement strategies, than about offense prevalence.

Estimates of Serious Civil Tax Violations
on Filed Returns

Table 4 presents rates for serious civil--as compared with criminal offenses--based upon the same TCMP data. Rates estimated for civil fraud averaged 9 per 10,000 across the three surveys.¹³ In contrast, estimated rates for negligence violations are much higher--123 per 10,000. Despite some suggestions of an increasing rate over time for civil penalty violations,¹⁴ estimates appear remarkably stable across surveys despite the small n's on which they were based (shown in Table 4).

The low rate for civil fraud raises questions. On its face, it is unclear why civil fraud penalties were asserted in less than half the cases referred for criminal investigation. Though TCMP survey instructions called for the completed survey forms (checksheets) even on

¹³This rate has been adjusted to take into consideration a small number of cases excluded from the sample because they were already under criminal investigation at the time of the TCMP survey. (See footnote 4 at Table 3.)

¹⁴Rates for negligence rose from 86 (1965) to 106 (1969) to 170 (1973). For example, other indications, however, suggest that the increase may reflect a change in enforcement policy, rather than any real increase in negligence violations.

**ESTIMATED RATES OF SERIOUS INCOME TAX OFFENSES: NEGLIGENCE,
CIVIL FRAUD AND CRIMINAL VIOLATIONS
(Income Tax Returns Filed by Individuals)**

	Returns With Violations Within Combined TCMP Samples ¹	Rates per 10,000 Returns				Total Violations on Filed Returns ²		
		TCMP Tax Years			Average Across Samples (adj) ³	Estimated Occurrence on Returns Filed ⁴	Estimated Penalties Currently Detected ⁵ By Audits	Percent Detected
		1965	1969	1973				
Criminal Penalties								
Referrals	668	22	16	17	20	175,000 ⁶	7,000 ⁶	4%
Offense(s)	-	-	-	-	-	10,000 ⁶	400 ⁶	4%
Civil Penalties								
Civil fraud	238 ⁷	6 ⁷	7 ⁷	8 ⁷	9 ⁷	80,000 ⁷	6,400	8% ⁷
Negligence	3,068	86	106	170	121	1,100,000	64,000	6%
Other	4,991	117	103	109	237	2,100,000	na	na
Total civil ⁸	8,297	209	216	287	365	3,200,000	na	na

¹Total combined sample size in the three TCMP surveys (Phase III, Cycles 2, 3, 5) was 140,376 returns. The sample was a stratified cluster design. Figures indicated within this sample are the number of returns on which these specific violations were found.

²1978 Estimates.

³Adjusted for sample exclusions of cases which were already under criminal investigation (see footnote 2 of Table 3). Adjustments in case of criminal and civil fraud were based on the ratio of estimated exclusions to total returns with violations of type shown.

⁴Estimated rates in the column labeled "Average Across Samples" are applied to the number of individual income tax returns filed in 1978 of 87,386,093. Numbers are rounded to emphasize the lack of precision inherent in the estimation process; because of rounding components of civil penalties do not add precisely to total, which has been rounded to 3.2 million.

⁵Since criminal referrals from the Examination Division and prosecutions resulting from this source on income tax returns for individuals were not separated from total examination referrals, figures shown are estimated from those totals reported.

⁶The rate of criminal convictions resulting from audit referrals in the regular audit program was used as the basis for estimating criminal tax offenses from TCMP referrals. As a result, the rate of "detection" for potential referral versus potential criminal offenses is mathematically identical.

⁷The estimate for rate of civil fraud appears much too low, thus inflating the estimate of the proportion of violations detected; since the number of TCMP returns for which civil fraud penalty was assessed is only a third of those referred for criminal prosecution, it appears that this item was unreliably filled out by TCMP examiners.

⁸The counts reflect not the number of civil violations, but the number of returns on which civil penalties were asserted. Only the principal civil penalty asserted was checked. While these counts should reflect any penalties asserted during the TCMP audit, instructions received by the TCMP examining officer are not entirely clear whether penalties asserted at the service center such as for late filing or payment were counted or not. Since the rate of assertion of such penalties in 1978 greatly exceed that based upon TCMP results (total assessments on individual income tax returns was almost 7,000,000) it is clear that they were usually not included. It is unclear, however, whether these penalties were consistently excluded in the adjustment counts on all TCMP returns.

Source: Unpublished internal computer tabulations (diagnostic and RAT tables, TCMP Phase-Cycles III-2, III-3, III-5, unpublished internal statistics of Examination Division, Criminal Investigation Division, and Service Centers.

cases referred for criminal investigation, this procedure differs from normal audit practice and may not have been done consistently.

Incomplete survey forms on TCMP criminal referrals--while not affecting total survey estimates on most items--would materially affect our civil fraud counts.

Because of the low priority assigned by IRS to TCMP data on criminal referrals (and the few number of TCMP cases on which a criminal referral occurred), this aspect of the survey design may not have been closely monitored. Further, though an internal audit of each TCMP survey was conducted by IRS Internal Audit Division, to verify that required procedures were properly carried out, these covered such small subsamples of each TCMP survey that it is possible few or no criminal investigation cases were included.¹⁵

The estimates for total civil penalties asserted--around 3.2 million-- is also widely at variance with penalties assessed, which in 1978 on individual income tax returns alone amounted to nearly 7 million (Annual Report of the Commissioner, 1978;95). Some of this difference may be explained by the TCMP sample design which covered only returns filed during the 12 months following the close of the tax year. This would have excluded some delinquent filings. (See "Sample Design Methodology," and "Computer Selection of IMF TCMP Sample," unpublished IRS reports on various TCMP cycles.) Nonetheless, the size of the difference suggests that assessments made by Service Centers for late

¹⁵ The rate computed on TCMP audits, however, may also reflect inconsistencies in IRS policies in asserting the civil fraud penalty. A 1974 internal agency report on the civil fraud penalty concluded that it was often not asserted in cases returned from criminal investigation, though practices differed widely by office (Task Force Report on Civil Fraud Penalty, 1974).

filing or late payment may not have been consistently included on the TCMP checksheets.

Figures in Table 4 also provide some estimates of potential enforcement workloads if all serious violations were subject to detection and punishment. Were this to occur, the Criminal Investigation Division (CID) would experience an estimated twenty-fold increase in cases.¹⁶ Current CID special agents number 2,800, not counting supporting and clerical CID staff. Twenty times 2,800 would be 56,000, or approximately twice the total number of enforcement officers in audit, collection and criminal investigation combined. With a comparable increase in support staff, CID would require more than the current IRS workforce just to process criminal referrals.

This, of course, does not take into consideration the vast expansion in civil auditors and revenue agents required to generate these referrals, or the increase in attorneys at IRS, Justice, and in U.S. Attorney's offices needed to handle the increase in court prosecutions. Currently, for example, only 1 in 50 returns receive a civil audit. Even if more efficient means were developed to select cases with criminal potential,¹⁷ it would require a vast increase in audit staffing to generate these referrals. An across the board,

¹⁶ This assumes that the rates of audit referrals to total violations detected by audits is the same as the ratio of referrals from other sources relative to the remaining violation.

¹⁷ Unlike the civil area, little systematic work has been done by IRS to develop a DIF-like formula to predict potential criminal tax violations. While IRS staffing formula currently allocates criminal investigators in part as a form function of civil DIF score distributions, there is no hard information that civil DIF scores are predictive of criminal violation rates.

twenty-fold in increase in IRS enforcement persons (who now total over 27,000) would mean a staff of over a half million agents.

Variations in Serious Violations
by Taxpayer Class

Not unexpectedly, the rate of serious violations varies sharply with income source. (Presumably, it also varies by level of income, but IRS did not prepare tabulations relating violations to the level of actual -- rather than reported -- income.)

As shown in Table 5, individuals receiving income from business, farm or a profession have violation rates 5 to 9 times higher than wage-earners or salaried individuals.¹⁸ One might guess that this reflects greater opportunities for evasion by business and professionals; it may also reflect the relative ease with which criminal intent can be shown for violations typical to the two groups -- understatement of (business) income versus overstatement of deductions (wage-earners). The rates again, even with the further breakdown, showed stability across surveys. Because business returns make up only 12 percent of the total N, expected sampling variability as we observe is somewhat larger for these estimates.

CONCLUSIONS

Alternative ways to measure offense prevalence -- particularly where victim reports are either not applicable or available as for many white collar crimes -- are needed. Without measures of the extent or

¹⁸Serious violations by corporations are not covered, of course, in these tabulations--only serious violations on returns filed by individuals.

TABLE 5

COMPARISON OF ESTIMATED SERIOUS VIOLATION RATES BY OFFENDER CLASS
(Income Tax Returns Filed by Individuals: Rate per 10,000 returns)

	All Returns			Wage-earners and Salaries (nonbusiness)				Business and Professional				Ratio of Violation on Business to Nonbusiness Sample Returns	
	TCMP Tax Year			TCMP Tax Year				TCMP Tax Year ²					
	1965	1969	1973	Average Across Samples (adj)	1965	1969	1973	Average Across Samples (adj)	1965	1969	1978		Average Across Samples (adj)
Criminal Referrals	22	16	17	20	14	8	6	10	70	71	97	87	9
Civil Penalties													
Civil Fraud	6	7	8	9	3	5	3	5	28	17	51	40	8
Negligence	86	106	170	121	54	64	125	81	293	413	506	404	5
Other	209	216	287	237	125	154	199	159	758	668	944	790	5
Total civil	301	329	465	365	182	223	327	244	1,079	1,098	1,501	1,226	5

¹Taxpayers filing a Schedule C (Business Income) or F (Farm Income) with their individual Form 1040 income tax returns are classed a "business and professional"; "wage-earners and salaried" are those referred to by IRS as nonbusiness returns) not filing a Schedule C or F.

²Because professionals' returns comprise only twelve percent of total returns expected sampling variability of these estimates is greater.

Adjusted for sample exclusions of cases which were already under criminal investigation (see footnote 2 of Table 3 and footnote 3 of Table 4). The same adjustment factor was used for wage earners and for business and professional return classes.

The counts reflect not the number of civil violations, but the number of returns on which civil penalties were asserted. Only the principal civil penalty asserted was checked. While these counts should reflect any penalties asserted during the TCMP audit, instructions received by the TCMP examining officer are not entirely clear whether penalties asserted at the service center such as for late filing or payment were counted or not. Since the rate of assertion of such penalties in 1978 greatly exceed that based upon TCMP results, (total assessments on individual income tax returns was almost 7,000,000) it is clear that they were usually not included. It is unclear, however, whether these penalties were consistently excluded in the adjustment counts on all TCMP returns.

Source: Taxpayer Compliance Measurement Program, Returns Filed Phase III, Cycle 2, 3, 5, weighted and unweighted diagnostic tables: 5/990, 9/990, 3/990; A, C tables (RAT).

seriousness of offenses, both research and policy decisions are constrained by lack of knowledge.

The approach examined here, the random investigation method, offers us one alternative. While not unknown to other agencies, it has been most extensively applied over the longest period of time by the Internal Revenue Service in measuring tax violations. Estimates derived from this I.R.S. data base indicate some of the potential uses and versatility of this measurement method. Despite limitations both in the types of offenses for which it is suited and the degree of accuracy and reliability of the data derived, nonetheless it does offer important advantages over our current state of ignorance. More research would help in determining what other types of offenses it is suited to measure (and what related cost factors would be), as well as in assessing the validity of the estimates derived.

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